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In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 127

FEDERAL POWER COMMISSION, PETITIONER

v.

UNITED GAS PIPE LINE COMPANY, NATURAL GAS PIPE LINE COMPANY OF AMERICA, AND TEXAS EASTERN TRANSMISSION CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION

OPINIONS BELOW

The opinion of the court of appeals (II R. 70–72)[1] is reported at 357 F. 2d 230. The opinion and order of the Federal Power Commission (II R. 32) are reported at 31 F.P.C. 1180. The Commission's decisions on the applications for rehearing are reported at 32 F.P.C. 687, 879, and 1163.

[1] The record in this Court consists of Joint Appendix, Volume I below, referred to herein as "I. R.," and Joint Appendix, Volume II below (as supplemented by the opinion of the court of appeals and other pleadings and documents in the court of appeals and in this Court), referred to as "II R."—the two volumes being bound together but paginated separately.

JURISDICTION

The judgment of the court of appeals setting aside the Commission's order was entered on February 10, 1966 (II R. 73–74). The petition for certiorari was filed on May 11, 1966, and granted on June 13, 1966 (II R. 75, 384 U.S. 984). The jurisdiction of this Court rests on 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

United Gas Pipe Line Company (United) is one of a group of affiliated corporations constituting an integrated gas utility system. The group files consolidated federal income tax returns. In the relevant period, the producing affiliates sustained tax losses while United (the transmission company) and the distributing company had substantial taxable income. By filing consolidated returns, and thus offsetting the tax losses of the producing members against the taxable income of United and the distributing affiliate, the group incurred a smaller tax liability than if each affiliate had filed a separate return. The question presented is whether the Federal Power Commission, in fixing United's rates, is nevertheless obliged to allow as a cost of service a tax allowance computed at the full separate-return rate.

STATUTES INVOLVED

The pertinent provisions of the Natural Gas Act, June 21, 1938, c. 556, 52 Stat. 821–833, as amended, 15 U.S.C. 717–717w, and of the Internal Revenue Code of 1954, 68A Stat. 3, *et seq.*, as amended, 26 U.S.C. 1, *et seq.*, are set forth in Appendix A, *infra*, pp. 29–32.

STATEMENT

This case began as a proceeding before the Federal Power Commission under Section 4(d) of the Natural Gas Act (App. A, *infra*, p. 29) to test the reasonableness of certain rate increases put into effect by United Gas Pipe Line Company.[2] The increases were disallowed. So far as relevant here,[3] the Commission ruled that United had improperly included in its cost of service an allowance for federal income taxes computed at the separate-return rate. United in fact files consolidated returns with affiliated corporations, and the consolidated filing results in a lesser tax liability for the group of affiliates than if they filed separate returns. The court of appeals vacated the Commission's order on the reasoning of the Tenth Circuit in *Cities Service Co.* v. *Federal Power Commission*, 337 F. 2d 97,[4] ruling that United was entitled to have its cost-of-service tax allowance computed at the separate-return rate.

1. BACKGROUND

United is a major interstate natural gas pipeline company. Forty-four percent of its sales are within

[2] The other respondents in this Court are pipeline customers of United who intervened in the Commission proceeding. They also file consolidated returns.

[3] Other issues—unrelated to the treatment of the consolidated tax savings—pertaining to the reasonableness of United's rates were involved in the proceeding before the Commission. Petitions to review one such issue were dismissed in *Texas Eastern Transmission Corp.* v. *Federal Power Commission*, 357 F. 2d 232 (C.A. 5). The others were settled. 32 F.P.C. 1515.

[4] We have printed the Tenth Circuit's opinion in App. B, *infra*, pp. 33–39.

the rate jurisdiction of the Federal Power Commission (II R. 54). It is a wholly owned subsidiary of United Gas Corporation (Gas Corporation), a smaller company whose principal taxable income is derived from the operation of several local gas distribution systems in Texas, Louisiana and Mississippi. These systems are subject to State and municipal rate regulation. Gas Corporation also owns all of the stock of Union Producing Company (Union), a domestic producer of oil and gas whose interstate gas sales are subject to Federal Power Commission regulation, and United Overseas Production Corporation (Overseas), which engaged in foreign oil exploration.

Union, United, and Gas Corporation constitute an integrated gas utility system from wellhead to consumer's premises. Union sells approximately 80 per cent of the gas it produces to United, and United furnishes Gas Corporation (the distributing arm of the system) with approximately 96 percent of the latter's gas.[5] United is by far the largest company in the system. Its gross revenues in 1951 were $298 million. In the same year, Gas Corporation's gross operating revenues were $50 million and Union's $52 million.[6]

Gas Corporation and its wholly owned subsidiaries, including United, elect, pursuant to Section 1501 of the Internal Revenue Code of 1954, App. A, *infra*, pp. 29–30, to file consolidated federal income tax returns.

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[5] *Union Producing Co.*, 31 F.P.C. 41, 43–44; 1964 Annual Report of United Gas Corporation, p. 4 (on file with Federal Power Commission).

[6] Moody's Public Utility Manual (1962), p. 1368.

In these returns (which all affiliates must join),[7] the taxable transactions of the four members of the affiliated group are combined to produce a single net taxable income, upon which the tax is computed. In determining the consolidated net taxable income, any tax losses sustained during the taxable period by a member of the group are offset against the taxable income of the companies having taxable income in the same period.[8]

Between 1957 and 1961—the representative period selected by the Commission—the United system, filing consolidated returns, paid $57,199,881 to the government in income (excluding capital gains) taxes (II R. 53). Had separate returns been filed, the total tax for the four companies for the same period (excluding the taxes that would have been paid on inter-company dividends)[9] would have been $59,291,919. The differ-

[7] To be "affiliated corporations" at least 80 per cent of the voting stock of each company must be in common ownership. 26 U.S.C. 1504(a), App. A, *infra*, pp. 30–31. Here, of course, the common ownership is 100 percent.

[8] Income and expense items resulting from transactions among the affiliates are excluded in computing the taxable income of the consolidated group. Thus, dividends paid by affiliates are excluded from the income of the receiving company; interest paid to affiliates is treated as income to the receiving company and a deduction to the paying company, and so cancel out (I R. 93–94).

[9] In the period in question, 15 percent of all dividends received by corporations were taxable as ordinary income. Hence, if inter-affiliate dividends were large, the tax savings to the consolidated group in this respect alone were substantial. During the five-year period, Gas Corporation received $66,567,028 in dividends from United and Union, on which a tax of about $5

ence—more than $2 million—reflects the fact that in the consolidated returns the group was able to set off Union's net tax losses of $3,869,626 and the $24,434 net tax loss of Overseas [10] against the income of United and Gas Corporation. United's total taxable income in this period was $105,290,983 and Gas Corporation's $9,024,170 (II R. 53).

Although it had tax losses, Union made substantial profits and paid dividends each year between 1952 and 1961. Its net income during the relevant five-year period was almost $70 million. (II R. 4.) Its tax-loss status is attributable entirely to the deductions for depletion and for intangible drilling and development costs permitted by the Internal Revenue Code (see 26 U.S.C. 613, 263(c)).

2. THE COMMISSION PROCEEDING

On June 15, 1962, United filed revised rate schedules with the Federal Power Commission increasing its rates overall. After a hearing to determine the lawfulness of the increased rates, the Commission ordered them reduced.

One of the issues relating to the lawfulness of the increases was whether the Commission could test the

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million would have been due had separate returns been filed. This is not an important source of tax savings for the future, since Section 214 of the Revenue Act of 1964 permits the exclusion of 100 percent of dividends received from affiliates. 78 Stat. 52, 26 U.S.C. 243.

[10] Overseas did not commence operations until 1961 (II R. 24), and so far as we have been able to determine has been defunct since 1961. With an average loss for the test period of less than $5,000, its significance to the issues here is negligible.

reasonableness of United's rates against its cost of service without including in that cost (as United proposed) the full amount of federal income taxes United *would* pay if it paid at the standard rate for corporate taxpayers filing separate returns. On this point, the Commission followed the procedure that it had recently enunciated in *Cities Service Gas Co.*, 30 F.P.C. 158,[11] to calculate the effective tax rate applicable to United. Under this procedure, the Commission (1) separates the affiliated corporations into regulated and unregulated groups; (2) determines the net taxable income of each group; and (3) apportions the total consolidated tax liability during the test period between the two groups and then among the companies in the regulated group in proportion to their respective taxable incomes.[12]

Under this method, any losses sustained by an unregulated company or activity must first be set off against the total income of all unregulated operations. Since, however, the unregulated activities in the present case produced no net taxable income during the relevant period, this preliminary step became unnecessary. The consolidated tax actually paid by the system during the test period was simply allocated

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[11] Its order in that case was subsequently set aside by the Tenth Circuit. See p. 3, *supra*.

[12] In no event may "the allowance so computed for the regulated company * * * exceed what its tax liability would be for rate making purposes, if computed on a separate return basis" (*Cities Service*, *supra*, 30 F.P.C. at 164).

between the two profit companies, Gas Corporation [13] and United, in proportion to their taxable incomes (excluding capital gains) for the five years.

United's taxable income was 92.11 percent of the total. The percentage, applied to the system's average annual tax of $11,439,976 during the test period, yielded the amount ($10,537,362) deemed by the Commission to be United's fair share of the tax. This amount was 50.04 percent of United's average annual taxable income of $21,058,197. In the Commission's view, therefore, 50.04 percent—not 52 percent, the rate at which United would have paid federal income tax had it filed separate returns—was United's effective tax rate and the proper basis for determining United's test-year tax allowance for rate purposes (II R. 41–42, 53).

3. THE COURT OF APPEALS' DECISION

United filed a petition in the Court of Appeals for the Fifth Circuit to review the Commission's ruling, contending that it was entitled to compute its federal income tax allowance for rate-making purposes at the separate-return rate. The court of appeals agreed and vacated the Commission's order. In a brief opin-

[13] We point out that, in regulating Gas Corporation's rates, the State of Mississippi does not require that consolidated-return savings be reflected in the rates. *Mississippi Public Service Commission* v. *Southern Bell Tel. & Tel. Co.*, 16 P.U.R. 3d 415, 454 (Miss. P.U.C.). Louisiana and Texas, however—the other States that regulate Gas Corporation's distributing operations—evidently do. See *Ex Parte Southern Bell Tel. & Tel. Co.*, 26 P.U.R. 3d 55, 110–111 (La. P.S.C.); *State* v. *Lone Star Gas Co.*, 86 S.W. 2d 484, 503, 11 P.U.R. (N.S.) 283, 311 (Tex. Ct. Civ. App.); but see *San Antonio Transit Co.* v. *City of San Antonio*, 323 S.W. 2d 272, 275 (Tex. Ct. Civ. App.).

ion (II R. 70–72), it adopted the reasoning of the Tenth Circuit in *Cities Service Gas Co.* v. *Federal Power Commission*, 337 F. 2d 97 (App. B, *infra*, pp. 33–39). Neither opinion is addressed to the particulars of the Commission's allocation method—the three-step procedure described above. Both find the Commission powerless to make *any* allocation, and hold that United was entitled to have federal income tax included in the cost of service used to test the reasonableness of its rates at the full 52-percent rate for separate corporate returns. The Tenth Circuit stated (337 F. 2d at 100, App. B, *infra*, p. 37):

> We think it is legally fallacious to calculate the Gas Company's tax allowance on the basis of the consolidated tax liability of the parent Company. This approach cannot be justified by the actualities of the case. The uncontroverted facts show that the Gas Company not only incurred a tax liability during the representative years at the statutory 52 percent rate, but its tax liability at that rate was reported to the parent Company, and the consolidated returns actually reflect that tax liability.

SUMMARY OF ARGUMENT

The court below held that where an integrated gas utility system files consolidated federal income tax returns, in which the tax losses of the producing affiliates are offset against the taxable income of the transmission and distributing members, no part of the resulting tax savings may be allocated for rate-making purposes to the transmission company (United), even though that company contributed the

principal portion of the system's taxable income. The court reasoned that the profit members of the group made no contribution to the savings and that therefore their ratepayers should not share that benefit in the form of lower rates.

I.

The court's reasoning, we submit, distorts economic realities and is contrary to sound principles of public utility regulation.

A. In no meaningful sense were the tax savings attributable exclusively to the tax-loss corporations. A tax loss in itself gives rise to no tax benefit. For such a benefit to result, there must also be taxable income against which to offset the loss. That indispensable condition was largely created here by United—and its ratepayers. It is they who assure the steady profits necessary to take advantage of the producing companies' tax losses.

B. United's ratepayers also made a direct and substantial contribution to the operations giving rise to those losses. The business of the producing company in which nearly all the losses were sustained—United—is only nominally separate from the pipeline and distributing operations of the integrated system. As a regulated public utility enjoying a quasi-monopolistic position, United gives the system an assured source of substantial profits. This in turn facilitates additional ventures like oil and gas exploration, both by providing a substantial cushion against the risk of loss in those undertakings and by guaranteeing that any tax losses incurred in them can be converted immedi-

ately into a cash savings in federal income taxes by filing consolidated returns. The presence of a pipeline company of United's magnitude in an integrated system also facilitates the raising of venture capital on advantageous terms. United contributes additional support to the producing companies' operations by providing an assured market for their gas output.

It is also relevant that the tax losses of the producing companies were not business losses in the sense that there was an excess of expenses over revenues. By virtue of generous allowances available to the oil and gas industry, the producing companies enjoyed business profits and tax losses. Since the stockholders did not suffer impairment of their capital or earnings because of these tax losses—which were wholly benign—it can hardly be said that a reasonable allocation of the tax savings operates harshly upon investors.

II.

The result we urge is consistent with the relevant provisions of the Internal Revenue Code. Contrary to the view of respondents, the Code does not provide that tax liability at the separate-return rate continues when the taxpayer joins in a consolidated return. Moreover, the only purpose of the consolidated-return privilege is to recognize that a group of affiliated corporations is, despite its corporate form, a single business entity. This precept is not impaired by an allocation of consolidated tax savings among the member corporations—a procedure the Code expressly recognizes. Certainly, in permitting consolidation, Congress had no intention of precluding the Federal

Power Commission from applying normal regulatory principles to the corporations within its rate-making jurisdiction.

ARGUMENT

INTRODUCTION

In testing the reasonableness of the rates of a natural gas pipeline company, the Federal Power Commission follows traditional public utility rate-making principles, under which the company's stockholders are entitled to a fair return—no more and no less—on their investment. Sound application of this rule obviously depends upon an accurate ascertainment of the costs incurred by the company in providing the service for which the rate is to be fixed. And since the focus is on the yield to the stockholders rather than on the operating profits of the company, federal income taxes paid by the company are treated as an item of cost of service.

Determination of the cost of providing a particular service is often difficult, especially where the service is provided by a diversified business entity. Unless the pipeline operations subject to the Commission's rate jurisdiction are completely segregated from the concern's other operations, it may be improper to assign the whole of a particular expense to either pipeline cost of service or non-pipeline operations. Examples of such an expense—or "joint cost"—would be rent paid by the concern for occupancy of a building housing both pipeline and nonpipeline employees and the salary it pays its comptroller who keeps all the books of the concern. If the true pipeline cost of serv-

ice is to be determined, such an expense item must be allocated between pipeline and non-pipeline operations in accordance with business reality. See *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 586–589. If, in our examples, rent and salary are assigned wholly to pipeline operations, and their full amount included in the pipeline cost of service, the ratepayers will be defraying an expense part of which was not incurred in providing them with pipeline service; they will be subsidizing other business ventures of the company. If, on the other hand, rent and salary are assigned wholly to non-pipeline operations, the stockholders will be prevented from recouping in full the actual cost of providing pipeline service to the ratepayers.

The need for allocation is equally clear with respect to *savings* in joint costs. Suppose the landlord refunds a portion of the rent, or the comptroller returns a portion of his salary because it was paid by mistake. If the entire amount is credited to pipeline cost of service and thus passed through to the ratepayers, they receive a partial windfall—the benefit of a reduction in a cost partly incurred in another business venture the expenses of which were not defrayed by the ratepayers in the first place.[14] On the other hand, if no part of the reduction in cost is credited to pipeline cost of service, the stockholders will receive a rebate of an expense which the ratepayers originally bore.

[14] This assumes, of course, that the rent or salary originally was properly allocated between pipeline and non-pipeline operations.

The present case involves a specific application of these settled principles of cost allocation. United Gas Pipe Line Company is a member of a group of affiliated corporations which files consolidated federal income tax returns. In the relevant period, United furnished most of the taxable income of the group. Other members—companies engaged in oil and gas production—sustained sizable tax losses. By filing consolidated returns, the group was permitted by the Internal Revenue Code to offset the tax losses of the producers against the taxable income of the other members, resulting in lower taxes than if each member had filed separate returns. The issue is whether it is improper for the Commission to allocate any part of the tax savings to United as a reduction in its cost of service. Stated otherwise, it is whether United is entitled to include in its cost of service the full measure of federal taxes it would have paid had it filed separately; if so, no part of the tax savings obtained by the consolidated filing in which United participated will inure to the benefit of its ratepayers. The Commission, with one exception, has been consistent in requiring allocation in these circumstances. *Home Gas Co.*, 13 F.P.C. 241, 246; *United Fuel Gas Co.*, 12 F.P.C. 251, 264–265; *Hope Natural Gas Co.*, 10 F.P.C. 625; *Penn-York Natural Gas Corp.*, 5 F.P.C. 33, 38–39; but see *Olin Gas Transmission Corp.*, 17 F.P.C. 685.

We emphasize that the issue is a clear-cut one—allocation *vel non*. The proper formula of allocation—

how much of the tax savings is to be assigned each member of the group—is not an issue here. The court below did not criticize the particular formula utilized by the Commission (which, as applied to the facts of this case, results in allocating the whole of the savings to the companies that had taxable income). The court held, rather, that the Commission was without power to make *any* allocation; all of the savings must go to the loss companies.[15]

This position might have considerable cogency if the tax savings were indeed wholly attributable to the non-pipeline operations of the consolidated group, and if, in addition, those operations were in nowise supported by the pipeline operations. As we shall show, neither condition obtains. United—and its ratepayers—play a vital role in the conversion of the system's tax losses into a positive financial benefit. And United—and its ratepayers—support, importantly albeit indirectly, the nominally separate activities (both regulated and unregulated) of the producing companies which give rise to the tax losses. Hence, allocation is clearly justified by sound regulatory principles. As we shall also argue, this result is not opposed to the policy and design of the relevant provisions of the Internal Revenue Code.

[15] This is the reasoning of *Cities Service Co.* v. *Federal Power Commission*, 337 F. 2d 97 (C.A. 10), App. B, *infra*, pp. 33–39, on which the court below, in its brief opinion, expressly relied.

I.

UNITED'S RATEPAYERS ARE ENTITLED TO SHARE IN THE TAX SAVINGS OBTAINED BY FILING CONSOLIDATED RETURNS; THEY PLAYED A CRUCIAL ROLE IN THE TRANSFORMATION OF TAX LOSSES INTO TAX BENEFITS AND THEY CONTRIBUTED MATERIAL SUPPORT TO THE ACTIVITIES IN WHICH THE LOSSES WERE SUSTAINED

A. THE MEMBERS OF THE CONSOLIDATED GROUP WHO—LIKE UNITED—HAD TAXABLE INCOME WERE INDISPENSABLE TO THE REALIZATION OF TAX SAVINGS FROM THE TAX LOSSES OF THE PRODUCING COMPANIES

By filing consolidated federal income tax returns under Section 1501 of the Internal Revenue Code, the United gas system was able to set off the tax losses of the producing affiliates (principally Union) against the taxable income of the transmission and distribution affiliates (United and Gas Corporation). H[illegible] the members of the consolidated group filed separate returns all of the system's taxable income would have been taxed. The tax savings produced by the consolidated filing was more than $2 million in the relevant period.

1. Without tax losses to set off against taxable income, there would, of course, have been no tax benefit to be obtained by filing consolidated returns. Equally, however, without taxable income the tax losses could not have been translated into tax savings. If United and Gas Corporation had not had any taxable income, the group would not have received, as it did, the equivalent of a $2 million rebate as a result of the producing members' losses. And since the income was

very largely contributed by United's ratepayers,[16] we submit that they are entitled to share in the resulting tax benefit. Stated otherwise, since federal income tax is a cost of service that the customers of a regulated utility defray in the rates they pay, a tax reduction that is at least partly attributable to the taxpayer's regulated operation should be applied, at least partly, to reducing those rates.

It is relevant in this connection that United and Gas Corporation—the members of the consolidated group that furnished all of its taxable income—are both regulated public utilities. The profitability of these franchised monopolies is virtually guaranteed; constitutional requirements apart, it is a guiding principle of public utility regulation to avert any impairment of the regulated company's financial soundness. The value of the consolidated-return device as a method for obtaining tangible monetary benefits from tax losses is, thus, substantially enhanced when the affiliated group includes a natural gas pipeline company of United's magnitude. Such a group is virtually certain to have a steady source of profits (the *sine qua non* of benefiting from filing consolidated returns) large enough to cover its tax losses. The ultimate source of the profits—the guarantors, as it were, of the tax savings—are United's ratepayers.

2. It is no answer to say that United did not contribute to the tax savings because Gas Corporation's taxable income was sufficient in itself to cover the pro-

[16] United provided more than 90 percent of the system's income. Statement, *supra*, p. 8.

ducing companies' losses and so enable the savings to be realized. It is completely arbitrary to regard Gas Corporation as having made the decisive contribution. One could argue with equal force that United (which had the bulk of the system's taxable income) furnished the necessary income to cover the losses and that Gas Corporation's income was superfluous—an argument which would require that, as between United and Gas Corporation, the savings be allocated wholly to the former. Sound economics requires the conclusion that each contributed *pro rata*.

Section 1501, moreover, expressly requires each member of an affiliated group to join in the consolidated return, and the benefits of the device are forfeited if the income of any member is omitted (26 C.F.R. 1-1502-18). The group thus could not have elected to exclude United from the consolidated filing.

Nor is it an answer that, in light of the loss carry-back and carry-forward provisions of the Code,[17] the tax losses sustained by the producing companies might conceivably have given rise to tax savings even if separate returns had been filed. These provisions depend upon the loss corporation's having taxable income within the prescribed time periods sufficient to absorb the losses, and there is no indication that these are likely contingencies for the producing members of the United system.[18] Moreover, an affil-

[17] 26 U.S.C. 172 permits a corporation to offset tax losses against taxable income earned within three years before or five years after the losses were sustained.

[18] There is no contention that the five-year period utilized by the Commission in determining the average tax liability of United is not representative.

iated group that elects to file consolidated returns loses the right to utilize the carry-back and carry-forward provisions for its individual members (26 C.F.R. 1-1502-31(a)(2)-(5), -31(b)(2)(iv)). The group thus must choose which method of offsetting tax losses against taxable income—separate filing with loss carry-back or carry-forward by individual members or consolidated filing—is the more advantageous method for it.

The group of which United is a member has chosen the latter; it has decided that the savings will be greater by offsetting the tax losses of its producing members against the assured income of United and Gas Corporation than by speculating on the prospects for taxable income of the producing companies. In these circumstances, the contention that the consolidated-return device is not necessary to reap the full tax benefit of the group's tax losses is decidedly unpersuasive.

B. THE OPERATIONS IN WHICH THE TAX LOSSES WERE SUSTAINED WERE SUPPORTED IN A MEANINGFUL SENSE BY UNITED'S RATEPAYERS

Above, we considered the question of allocation of tax savings from the standpoint of whether United's ratepayers could realistically be said to have contributed to the conversion of the tax losses into an affirmative monetary benefit. There is, however, an additional dimension to the allocation problem. Since the tax savings which result from permitting businessmen to offset losses against income in computing their tax liability would appear designed for the benefit of the business entity as a whole—in this case, the United gas

utility system[19]—it is relevant to consider to what extent, if any, United's ratepayers may have supported the ventures in which the losses were sustained. If in a realistic sense the tax-loss ventures are at least partly theirs, there is additional basis for the Commission's conclusion that, for rate-making purposes, they should share in a tax benefit arising from those ventures. We submit that there is indeed a substantial interrelation between the group's pipeline operations—supported by United's ratepayers—and its tax-loss production activities.

1. The steady stream of substantial profits that the pipeline operations assure (see p. 17, *supra*) furnishes an important cushion against entrepreneurial risks—and hence a significant incentive for diversification into related fields like oil and gas production. The virtual certainty of large-scale profits from the pipeline guarantees both that losses from new ventures will be absorbed without impairing the stockholders' investment[20] and that their adverse impact will be mitigated through realization of the maximum tax savings made possible by the filing of consolidated returns.[21] The assurance of profitable pipeline oper-

[19] This principle holds whether the taxpayer is a single corporation or an affiliated group filing a consolidated return. As will appear, the purpose of the consolidated-return device was simply to eradicate artificial distinctions in tax treatment based on corporate form (see pp. 25–27, *infra*).

[20] The stockholders of Union and Overseas are the same as the stockholders of United and the parent company, Gas Corporation.

[21] The tax consideration is particularly important as an incentive to engage in oil and gas production, a field where substantial tax losses are commonly conjoined with large business profits (see p. 23, *infra*).

ations rests ultimately with United's ratepayers, who under the regulatory scheme are obliged to pay rates high enough to ensure a fair return to the pipeline's investors. The ratepayers are thus in effect underwriters of the investors' ventures.

There are additional dimensions to this participation. A large and profitable public utility system can raise capital for new enterprises on favorable terms; we point out in this connection that Union's entire capital has been furnished by the parent company of the system. *Union Producing Co.*, 31 F.P.C. 41, 47. Moreover, Union is a producer of both gas and oil, and its position as a gas producer is much strengthened by its affiliation with United. In United, Union has an assured market for its gas; and since its rates to United are fixed by the Commission so as to cover its cost of service plus a fair return on investment (*Union Producing Co., supra*), its costs (save in the unlikely event that they are deemed improvident by the Commission) are ultimately borne by United's ratepayers. The involvement of the ratepayers in the group's gas-production operations is thus appreciable. It is well recognized that the problems and risks for a gas producer lacking this kind of affiliation are greater. See *Southern Natural Gas Co.*, 29 F.P.C. 323, 336. Also, oil and gas production are intertwined; the two are commonly found together and producers frequently explore for them simultaneously. The backing that United's ratepayers supply Union's gas business perforce contributes to Union's oil ventures, where some of the tax losses (how much the record does not disclose) were sustained.

The short of it is that in an integrated system the pipeline company contributes substantially to the production end of the business. United's ratepayers were in effect partners of the system's investors in the gas and oil operations that gave rise to the tax losses and the resulting tax benefit. We need not go so far as to suggest that, as "partners," the ratepayers were entitled to share in the profits produced by the oil operations.[*] But since they did contribute substantially to the producing ventures which occasioned the tax losses, we submit that for regulatory purposes the savings should be allocated between the system's pipeline and oil operations in order to reflect the economic realities of the situation."

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[*] Despite its tax losses, Union was a profitable company at all times relevant to this case. See Statement, *supra*, p. 6; *infra*, p. 23.

[**] For a comparable approach in a different context, see *South Carolina Generating Co.* v. *Federal Power Commission*, 261 F. 2d 915 (C.A. 4). The Commission in that instance had allowed the regulated company, which because of a high debt-to-capital ratio and resulting high interest deductions had a low taxable income, only a tax allowance computed at the separate-return rate. The parent corporation claimed that, because of the regulated company's high debt ratio, the parent had had to reduce its own debt ratio and interest deductions, producing a proportionate increase in its taxable income. The court of appeals refused to sustain the Commission, holding that there should be an allocation of the consolidated tax (261 F. 2d at 920): "* * * [A]ctual costs should not be disregarded simply because the selling utility chooses to incur them in one place rather than another. The additional income tax is an unavoidable consequence of the service [for which the rate in question is charged] and whether [the parent corporation] elects to incur that cost directly or only indirectly through its wholly owned subsidiary, the relation to the total cost of service is the same." See, also, *Southwestern Bell Tel. Co.* v. *Kansas State Corp. Comm.*, 192 Kan. 39, 71–72, 386 P. 2d 515, 543–544.

2. There is no merit to the argument that the investors bear the brunt of Union's potential business losses and therefore should receive the entire benefit of any mitigation of that risk. They would not bear the *full* brunt of such losses—and the only issue in this case, we stress, is whether *any* allocation to the pipeline cost of service is proper. Costs allocable to gas production, including those arising out of unsuccessful exploratory efforts, are passed through to United's ratepayers in the rates charged United by Union (see p. 21, *supra*). The ratepayers might also suffer to the extent that the system invested in Union's, activities. More pointedly, Union's tax losses are not true business losses. Union's oil operations are in fact highly profitable (see Statement, *supra*, p. 6). Its tax losses reflect the policy of Congress to encourage gas and oil exploration by percentage depletion and generous allowances for drilling expenses. The system's stockholders are not in the least hurt by these losses. They produce only benefits—benefits to which the pipeline ratepayers must be recognized as important contributors.

II.

NOTHING IN THE RELEVANT PROVISIONS OF THE INTERNAL REVENUE CODE PRECLUDES ALLOCATION HERE.

In Point I, we argued that allocation of the consolidated tax savings was, in the circumstances of this case, a necessary application of sound regulatory principles. It is also consistent with the relevant principles of federal tax law. The Internal Revenue Code discloses no purpose to preclude the Commission from

applying its usual regulatory standards to tax savings obtained by the filing of consolidated returns.

A. There is no merit to the suggestion that the Internal Revenue Code imposes on the profit members of an affiliated group a liability at the separate-return rate. The *only* tax liability of a corporation participating in a consolidated return is for the amount (for which each affiliate is severally liable) computed on a consolidated basis (see 26 U.S.C. 1503 (a); 26 C.F.R. 1.1502–15(a), –30, –31). There is no liability at the separate-return rate.[24] To show such a liability as a cost of service is thus, from a tax as well as a regulatory standpoint, wholly fictitious.[25]

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[24] Thus, when a consolidated return is filed, "the tax shall be determined, computed, assessed, collected, and adjusted" on the consolidated-return basis (26 U.S.C. 1503(a)) and the consolidated-return liability may not be reduced by any agreement entered into by any members of the affiliated group (26 C.F.R. 1.1502–15(d)). In addition, the parent corporation generally is required to act as the sole agent for the affiliated group in filing the return and dealing with the Internal Revenue Service (26 C.F.R. 1.1502–16(a)). When the Tenth Circuit in *Cities Service* spoke of a "tax liability" of the regulated company "at the statutory 52 percent rate" as being "reported to the parent Company" (App. B, *infra*, p. 37), it was presumably referring to the transmittal of the initial computation prepared by the regulated company to the parent corporation. That, however, is no more than inter-company correspondence necessary to enable the parent to carry out its duties as agent. The initial computations are not the return (see 26 C.F.R. 1.1502–30(a), 1.1502–31, 1.1502–31(a)(1), 1.1502–31(b)(1), 1.1502–31(b)(2)).

[25] United seeks a tax allowance of 52 percent of its taxable income as separately computed, which would amount to $54,743,026. Under this theory, Gas Corporation likewise would recover reimbursement from its consumers computed at 52 percent of its own taxable income, which would be $4,548,894 for

Cf. *El Paso Natural Gas Co.* v. *Federal Power Commission*, 281 F. 2d 567, 573 (C.A. 5), certiorari denied *sub nom. California* v. *Federal Power Commission*, 366 U.S. 912.

B. There is no basis in the Code for an inference that the consolidated-filing privilege is designed exclusively to benefit the affiliates having tax losses. Were that the scheme, the statute (26 U.S.C. 1501) would not permit, as it does, any member of an affiliated group to block the filing of a consolidated return by withholding its consent. *Western Pacific R.R. Corp.* v. *Western Pacific R. Co.*, 197 F. 2d 994, 1003 (C.A. 9), reversed on other grounds, 345 U.S. 247. In point of fact, the Code expressly authorizes allocation, by a formula similar to that applied by the Commission here, for purposes of determining the earnings and profits of each affiliate. 26 U.S.C. 1552 (a)(1).[26]

C. The basic purpose of the consolidated-return privilege is simply to permit (at the option of the

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the same period. Thus the two companies together would claim $59,291,919, even though the consolidated taxes actually paid by the system for the test period were only $57,199,880.

[26] The United system has elected to follow this method. Thus, the corporate books on which the members report to their stockholders show that, of the actual consolidated tax of $57,386,940 for the 5-year test period (not adjusted for capital gain), the system allocated $51,385,509 to United, which is less than 49% of its taxable income as separately computed for that period (I R. 98–100):

"Year	Consolidated Tax	Allocation		
		Corporation	United	Union
1957	$13,560,947	$1,311,344	$12,249,603	0
1958	16,188,431	2,188,676	13,999,755	0
1959	11,373,289	1,400,049	9,973,220	0
1960	8,265,382	1,101,382	7,164,020	0
1961	7,998,991	0	7,998,911	0
Total	$57,386,940	$6,001,431	$51,385,509	0"

affiliated group) piercing the corporate veil and "taxing as a business unit what in reality is a business unit" (S. Rep. No. 617, 65th Cong., 3d Sess., p. 9). "The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise." S. Rep. No. 960, 70th Cong., 1st Sess., p. 14. To like effect, see, *e.g.*, *Burnet* v. *Aluminum Goods Co.*, 287 U.S. 544, 547; H. Rep. No. 704, 73d Cong., 2d Sess., p. 17; H. Rep. No. 1337, 83d Cong., 2d Sess., p. 87; H. Rep. No. 749, 88th Cong., 1st Sess., pp. 116, A186; S. Rep. No. 830, 88th Cong., 2d Sess., p. 148; *id.*, pt. 2, p. 265. The natural-gas industry has so read the legislative intent. Hearings on General Revenue Revision before the House Committee on Ways and Means, 83d Cong., 1st Sess., p. 1280.

Congress, in other words, desired to permit equal tax treatment between concerns that transact business through departments of a single corporation and those operating through subsidiary corporations. This purpose is neutral with respect to how a tax savings resulting from setting off tax losses against taxable income is to be allocated within the business enterprise for rate-making purposes. There is not the slightest indication that Congress has ever desired to trench upon the Federal Power Commission's regulatory powers in this respect. A general tax provision like Section 1501 is hardly an apt tool for resolving the

intricate and technical problems involved in the issue whether a pipeline's ratepayers are entitled to share (in the form of lower rates) in a tax savings occasioned by the system's losses in the producing end of the oil and gas business. These are problems of utility regulation, not taxation. We submit that it was no part of Congress' purpose in permitting the filing of consolidated returns to decide whether allocation of the resulting savings is required to carry out the purposes of the Natural Gas Act.

To be sure, Congress desired that a business entity which sustained losses in one of its affiliated operations should be allowed to translate them into tax savings to the extent it had taxable income (see p. 20, *supra*). It is also true that Congress, in granting generous tax allowances for depletion and drilling costs, desired to encourage oil and gas exploration and development. However, an allocation of the benefits as between investors and ratepayers of an integrated system to reflect their respective contributions to the enterprise does not impair these purposes. The system benefits from the tax savings, as Congress intended, whether the savings inure directly to the investors or whether they are reflected in lower rates which attract new business and improve the system's competitive position. See *El Paso Natural Gas Co.* v. *Federal Power Commission*, 281 F.2d 567, 571, certiorari denied *sub nom. California* v. *Federal Power Commission*, 366 U.S. 912.

CONCLUSION

The judgment below should be reversed.

Respectfully submitted.

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SEPTEMBER 1966.

APPENDIX A

The Natural Gas Act, June 21, 1938, c. 556, 52 Stat. 821–833, as amended, 15 U.S.C. 717–717w, provides in pertinent part:

> SEC. 4. (d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. * * *
>
> (e) Whenever any such new schedule is filed the Commission shall have authority * * * to enter upon a hearing concerning the lawfulness of such rate * * *. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the nautral-gas company * * *.

The Internal Revenue Code of 1954, 68A Stat. 3, *et seq.*, as amended, 26 U.S.C. 1, *et seq.*, provides in pertinent part:

> § 1501. Privilege to file consolidated returns.
>
> An affiliated group of corporations shall, subject to the provisions of this chapter, have the privilege of making a consolidated return with respect to the income tax imposed by chapter 1 for the taxable year in lieu of separate returns. The making of a consolidated return

shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all the consolidated return regulations prescribed under section 1502 prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. * * *

§ 1502. Regulations.

The Secretary or his delegate shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability. * * *

§ 1503. Computation and payment of tax.

(a) GENERAL RULE.—In any case in which a consolidated return is made or is required to be made, the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under section 1502 * * *.

* * * * *

§ 1504. Definitions

(a) DEFINITION OF "AFFILIATED GROUP".—As used in this chapter, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

(1) Stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned

directly by one or more of the other includible corporations; and

(2) The common parent corporation owns directly stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of at least one of the other includible corporations.

* * * * *

(b) DEFINITION OF "INCLUDIBLE CORPORATION".—As used in this chapter, the term "includible corporation" means any corporation except—

* * * * *

§ 1552. Earnings and profits.

(a) GENERAL RULE.—Pursuant to regulations prescribed by the Secretary or his delegate the earnings and profits of each member of an affiliated group required to be included in a consolidated return for such group filed for a taxable year beginning after December 31, 1953, and ending after the date of enactment of this title, shall be determined by allocating the tax liability of the group for such year among the members of the group in accord with whichever of the following methods the group shall elect in its first consolidated return filed for such a taxable year;

(1) The tax liability shall be apportioned among the members of the group in accordance with the ratio which that portion of the consolidated taxable income attributable to each member of the group having taxable income bears to the consolidated taxable income.

(2) The tax liability of the group shall be allocated to the several members of the group on the basis of the percentage of the total tax which the tax of such member if computed on a separate return would bear to the total

amount of the taxes for all members of the group so computed.

(3) The tax liability of the group (excluding the tax increases arising from the consolidation) shall be allocated on the basis of the contribution of each member of the group to the consolidated taxable income of the group. Any tax increases arising from the consolidation shall be distributed to the several members in direct proportion to the reduction in tax liability resulting to such members from the filing of the consolidated return as measured by the difference between their tax liabilities determined on a separate return basis and their tax liabilities (determined without regard to the 2 percent increase provided by section 1503(a)) based on their contributions to the consolidated taxable income.

(4) The tax liability of the group shall be allocated in accord with any other method selected by the group with the approval of the Secretary or his delegate.

(b) FAILURE TO ELECT.—If no election is made in such first return, the tax liability shall be allocated among the several members of the group pursuant to the method prescribed in subsection (a)(1). * * *

APPENDIX B

United States Court of Appeals
Tenth Circuit

JULY TERM, 1964

No. 7538

CITIES SERVICE GAS COMPANY AND
CITIES SERVICE COMPANY, PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT

ON PETITION TO REVIEW AN ORDER OF THE FEDERAL POWER COMMISSION

Harry S. Littman (*Conrad C. Mount, Jack Werner, George H. Hill, Jr., Melvin Richter* and *Richard Littell* with him on brief) for petitioners.

Richard A. Solomon (*Howard E. Wahrenbrock, Abraham R. Spalter* and *Cyril S. Wofsey* with him on brief) for respondent.

Before MURRAH, Chief Judge, and HILL, Circuit Judge, and ARRAJ, District Judge

MURRAH, *Chief Judge:* In an order of the Federal Power Commission approving a settlement of the rates charged by Cities Service Gas Company for

jurisdictional gas sales, the Commission reserved for future determination the Federal income tax allowance to be included in the cost of service underlying the approved settlement. This appeal is from a final order of the Commission determining that sole issue.

The stipulated settlement included as a part of the cost of service a tax allowance based upon the statutory corporate income tax rate of 52 percent applied to the agreed taxable income of the Gas Company for the test year 1958. And, that amount would be routinely granted as a cost of service but for the Gas Company's participation in consolidated returns filed by its parent, Cities Service Company.

Having elected to file consolidated returns under Section 1501, 26 U.S.C., Cities Service was required by Section 1504, 26 U.S.C., to include all affiliates in which it owns 80 percent or more of the stock. Under the consolidated returns the total tax liability was less than it would have been if each subsidiary had filed separate returns. The reduction in the total tax liability resulted from offsetting the losses incurred by certain nonregulated affiliates against the taxable income of all other affiliates; and the Commission determined a tax allowance which reflected th so-called "tax savings" effected by the consoli- ted returns. The decisive question is whether the Commission, in the exercise of its undoubted power to determine just and reasonable rates for jurisdictional gas sales, may, in these circumstances, take into account the losses of nonregulated and unrelated affiliates to calculate the tax allowance includible in the cost of service of a regulated company.

The Commission recognized the fundamental rate-making principle which requires a separation of regulated and nonregulated profits and losses in the determination of the tax allowance. And see *Colorado*

Interstate Gas Co. v. *F.P.C.*, 324 U.S. 581; *Panhandle Eastern Pipe Line Co.* v. *F.P.C.*, 324 U.S. 635. In obedience to this principle, the majority of the Commission rejected its Staff's theory which determined the tax allowance by taking the ratio of the Gas Company's income to the total income of the profit-making companies and applying this percentage to the total tax liability. The Commission characterized this theory as possessing "a quality of artificiality and instability which renders it unsatisfactory for rate-making purposes."

The majority of the Commission also rejected the determinations and recommendations of its Examiner who discarded the Staff's theory in favor of the settlement allowance based upon the statutory 52 percent rate. The Examiner could find no authority to support the theory that "consumers of natural gas sold in interstate commerce should have the benefit of 'tax savings' derived from business losses of unregulated corporations whose business activities are entirely unconnected with and dissimilar to those of the regulated natural gas company transporting and selling such gas."

Proceeding on the established premise that only actual costs—hence actual taxes—are properly includible in a rate base, a majority of the Commission held that the consolidated income tax liability is the "only real cost which was incurred by Gas Company in conjunction with the other Cities Service affiliates", and that to accept the Gas Company's approach based upon the statutory 52 percent rate would have the effect of determining jurisdictional rates "on the basis of converting a hypothetical tax payment into a prudent operating expense."

To comply with the rate-making principle of separating regulated and nonregulated profits and losses, and in conformity with the equally controlling actual

cost concept, the majority of the Commission devised a "method to be applied in computing the Federal income taxes to be included in the cost of service of a regulated company where the company has joined in a consolidated tax return with affiliates * * * (1) separate the companies into regulated and unregulated groups, (2) determine the net aggregate taxable income of each group, and (3) apportion the net total consolidated tax liability over a representative period of time between the two groups, and among the companies in the regulated group, on the basis of their respective taxable incomes; provided that the allowance so computed for the regulated company shall not exceed what its tax liability would be for rate-making purposes, if computed on a separate return basis."[1]

As the basis for the application of this formula, the majority first selected the consolidated returns filed for the years 1957, 1958 and 1959. After separating the affiliates into regulated and nonregulated groups, the Commission determined that during the pertinent period the nonregulated companies had no net taxable income and that no tax liability should therefore be assigned to that group. The total taxable income of the regulated affiliates, which included companies regulated by other Federal and State agencies[2], was deter-

[1] One Commissioner would have adopted the Staff's theory but reluctantly joined two Commissioners in applying the above described method in order to form a working majority. The other two Commissioners dissented, contending that the Examiner's recommendations should be adopted. The dissenters were of the opinion that "Apart from the fact that there are no tax savings attributable to the inclusion of Gas Company in the consolidated return, the majority view is unlawful because it has the effect of regulating nonutility enterprises beyond the Commission's jurisdiction."

[2] Included by the Commission in the so-called "regulated" group, in addition to the Gas Company, are Cities Service Pipe Line Co., and Lafitte Oil Traders, Inc., both subject to regula-

mined to be $61,652,662, of which the Gas Company's share was 67.93 percent. This percentage was then applied to the normalized consolidated tax liability of all affiliates, an average of $8,636,607 a year, to arrive at the tax allowance of $5,866,847. The stipulated settlement had provided for a tax allowance of $7,055,981 based upon the statutory rate of 52 percent of the net separate taxable income of the Gas Company in 1958. The difference between these two sums is the bone of contention.

We think it is legally fallacious to calculate the Gas Company's tax allowance on the basis of the consolidated tax liability of the parent Company. This approach cannot be justified by the actualities of the case. The uncontroverted facts show that the Gas Company not only incurred a tax liability during the representative years at the statutory 52 percent rate, but its tax liability at that rate was reported to the parent Company, and the consolidated returns actually reflect that tax liability.

Thus the consolidated return for 1957 shows a consolidated tax liability of $12,251,639 paid by Cities Service. If the Gas Company had filed a separate return, the consolidated tax liability would have amounted to $6,391,241, and the Gas Company's tax would have been $5,860,398 based upon the statutory 52 percent rate. The sum of these amounts precisely equals that which was actually paid by Cities Service. From this it is demonstrably clear that the inclusion

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tion by the Interstate Commerce Commission, and Kansas Gas Supply Company, subject to regulation by the Kansas Commission. Also included in this group is that portion of the income of Cities Service Gas Producing Co. and Cities Service Oil Co.—Delaware—subject to regulation by the Federal Power Commission. These companies, however, are primarily engaged in the wholly unregulated oil business.

of the Gas Company in the consolidated return increased the consolidated tax liability by 52 percent of the Gas Company's taxable income. No "tax savings" resulted from the inclusion of the Gas Company in the consolidated return.

Similarly, in both 1958 and 1959 the inclusion of the Gas Company in the consolidated returns directly affected the consolidated tax liability in the amount of 52 percent of the Gas Company's taxable income, notwithstanding the fact that in those years the other Cities Service affiliates had aggregate tax losses. Application of the loss carry-back provisions of the Internal Revenue Code permit the offsetting of these losses against the taxable income of these affiliates in 1955 and 1956,[3] thereby resulting in tax refunds. No reduction in the actual total tax liability was thus effected since the net effect of the inclusion of the Gas Company in the 1958 and 1959 consolidated returns was to reduce the refund by 52 percent of the Gas Company's taxable income. See table below.[4] The simple fact is that the tax liability of the Gas Company as reflected in the consolidated returns was not hypothetical, but an actual cost to the Gas Company.

We know, of course, that the Commission is free to choose most any method which it deems appropriate

[3] The regulations promulgated pursuant to § 1502, 26 U.S.C. provide in accordance with § 172, 26 U.S.C. that a net loss in any year can be carried back to the three preceeding years or carried forward to the succeeding five years. 26 C.F.R. Part 1, § 1.1502-31(a)(4).

[4] See the following table:

"Year	(1) Consolidated Tax (including Gas Company)	(2) Consolidated Tax (excluding Gas Company)	(3) Gas Company's Separate Tax	(4) Sum of (2) plus (3)
1957	$12,251,639	$9,391,241	$5,860,398	$12,251,639
1958	(3,857,122)	(12,724,656)	6,867,534	(3,857,122)
1959	2,965,014	(5,966,531)	8,931,545	2,965,014"

in the determination of just and reasonable rates for jurisdictional gas sales,—usually a legitimate end justifies the means. See; *Colorado Interstate Gas Co.* v. *F.P.C., supra; Panhandle Eastern Pipe Line Co.* v. *F.P.C., supra; Wisconsin* v. *F.P.C.*, 373 U.S. 294. But, we know equally well that the method utilized must surely be within acknowledged jurisdictional limits which require an effective separation of regulated and nonregulated activities for the determination of the ingredients of the rate base. As applied to our case, it means a separation of profits and losses between regulated and nonregulated businesses in determining the tax allowance includible in the cost of service of the regulated company. "Otherwise the profits or losses, as the case may be, of the unregulated business would be assigned to the regulated business and the Commission would transgress the jurisdictional lines which Congress wrote into the Act." *Panhandle Eastern Pipe Line Co.* v. *F.P.C., supra,* p. 641.

And, as we have seen, the total tax liability is not affected when the Gas Company's tax liability at the 52 percent rate is included in the consolidated returns. Rather, the reduction in the total tax liability effected by the consolidated returns is due to the losses of the nonregulated companies. But, even so, under the Commission's method, the tax allowance of the Gas Company is made to depend upon the profits or losses, as the case may be, of the nonregulated companies.

It is thus plain that the apportionment of the total tax liability among the regulated companies fails to comply with the jurisdictional requirement for the separation of regulated and nonregulated profits and losses which Congress wrote into the Act, and which the Commission prescribed for itself. The Commission's method is therefore unauthorized and its order based thereon must be set aside.

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